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October 23, 1998

BY COURIER

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas
Federal Communications Commission
Room 222
1919 M Street, NW
Washington, DC 20554

Re: CC Docket No. 98-79; CCB/CPD 97-30

Dear Ms. Salas:

Please find attached a letter from the undersigned, counsel to ICG Communications, Inc., with regard to the above-referenced proceeding.

Please contact me if you have any questions.

Sincerely,



Albert H. Kramer

AHK/gsw

cc: Kevin Martin

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OCT 23 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

October 23, 1998

Mr. Kevin Martin
Office of Commissioner Harold Furchtgott-Roth
Federal Communications Commission
1919 M Street, N.W.
Room 802
Washington, D.C. 20554

WRITTEN EX PARTE
PRESENTATION

Re: CC Docket No. 98-79; CCB/CPD 97-30

Dear Mr. Martin:

This letter is to follow up on the meeting you had recently with Cindy Schonhaut, Senior Vice President of Government and External Affairs, ICG Communications, Inc. ("ICG"), and Michael Carowitz and the undersigned, counsel to ICG. In our meeting we discussed the Commission's forthcoming action in the above-referenced docket and possible options for the Commission to take to ensure that the Commission's forthcoming order in the tariff investigation does not have any unintended impact on reciprocal compensation for dial-up calls to Internet service providers ("ISPs").

Yesterday, yet another state, California, has joined 21 other states in finding that dial-up calls to ISPs are local, *intrastate* calls that are subject to reciprocal compensation. No state has found to the contrary. In a press release issued by the California Public Utilities Commission ("California PUC"), as well as in the draft decision that was circulated prior to the state commission's action, the California PUC stated that its

determination that [calls to ISPs] are local calls aligns with the FCC's report on Universal Service which indicates that internet access includes more than one component – a connection over a local exchange network and an information service. Since these calls are local calls, reimbursement for their costs is guided by the interconnection agreements between local service providers.

Once again, in the face of continuing state decisions finding that calls to ISPs are local, we urge the Commission to recognize that such calls are *intrastate* in nature and within the states' Section 252 authority over interconnection agreements. The Commission should avoid taking any action in the above-referenced proceeding that would upset the careful balance envisioned by the Telecommunications Act of 1996. Instead, consistent with the integrity of the Act, the Commission can respect state authority by allowing the tariffs for DSL service to stay in effect because DSL service can have interstate

applications. The Commission should not make a determination about the jurisdictional nature of calls to ISPs in these proceedings.

For your convenience, I have attached both the California PUC's press release and its draft opinion.

Please call me directly if you have any questions or concerns.

Very truly yours,

A handwritten signature in black ink that reads "Albert H. Kramer /mc". The signature is fluid and cursive, with a small "mc" at the end.

Albert H. Kramer

AHK/mjo



California Public Utilities Commission

107 S. Broadway, Rm. 5109, Los Angeles CA 90012

NEWS RELEASE

www.cpuc.ca.gov

CONTACT: Kyle DeVine
213-897-4225

October 22, 1998

CPUC - 551
H-6 (R94-04-043)

CPUC MAINTAINS JURISDICTION OVER ISP CALLS

The California Public Utilities Commission (CPUC) today affirmed jurisdiction over telephone calls between consumers and Internet Service Providers (ISPs), and determined that they are local calls if they are completed within the callers local service area. Thus, when that local call begins from one local phone company's network and ends at another local company's network, the originating company pays the cost of terminating the call.

Typically, an ISP provides internet access to its customers by providing local telephone numbers for customers to dial to reach the ISP. Disputes have arisen over whether the CPUC or the Federal Communications Commission (FCC) has jurisdiction over these calls and how to bill them. The CPUC's determination that they are local calls aligns with the FCC's report on Universal Service which indicates that internet access includes more than one component - a connection over a local exchange network and an information service. Since the calls are local calls, reimbursement for their costs is guided by the interconnection agreements between local service providers. The agreements state that costs for local calls which originate from one carrier and end at another will be covered by the originating carrier.

The telephone numbers ISPs provide are usually within a consumer's local phone service area - often referred to as the LATA. Depending on the distance between the caller and where the number resides, the consumer's cost for the call may be covered as part of the monthly service charges or toll charges may apply. □

Duque/tjs

DRAFT

Item H-6a
Agenda 10/22/98Draft Alternate Decision of Commissioner Duque

(Revised 10/8/98)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the
Commission's Own Motion into Competition for
Local Exchange Service.

• Rulemaking 95-04-043
(Filed April 26, 1995)

Order Instituting Investigation on the
Commission's Own Motion into Competition for
Local Exchange Service.

Investigation 95-04-044
(Filed April 26, 1995)

OPINION

By this order, we affirm our jurisdiction over telephone traffic between end users and Internet Service Providers (ISPs), and seek further information to determine what pricing policies, consistent with applicable statutes, best serve California's needs for an advanced telecommunications infrastructure. We therefore defer ruling at this time that such calls are subject to the bill-and-keep or reciprocal compensation provisions of applicable interconnection agreements until we more closely examine this policy issue.¹

¹ Under standard reciprocal compensation provisions of interconnection contracts, the cost of providing access for a customer's local call that *originates* from one local exchange carrier's network and *terminates* on another local exchange carrier's network is attributed to the carrier from which the call originated. (47 CFR Sec. 51.701(e), 51.703 (1997).) Such "local" calls are distinct from "long distance" calls which merely pass through interexchange switches and involve access charges rather than reciprocal compensation fees.

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Background

On March 18, 1998, the California Telecommunications Coalition (Coalition)² filed a motion in the Local Competition Docket seeking a ruling regarding the jurisdictional status and billing treatment of telephone calls utilizing a local exchange number to access ISPs. Disputes have arisen in interconnection agreements over which carrier should pay for the cost of terminating calls originated by customers of the incumbent local exchange carrier (ILEC) to access ISPs which, in turn, are telephone customers of a competitive local carrier (CLC). Typically, an ISP purchases telephone lines located within the local calling area of its customers to provide Internet access by having the customer dial a local number over an ordinary telephone line. Such calls are rated as local, thus allowing the caller to utilize the ISP's service without incurring toll charges. The ISP then converts the analog messages from its customers into data "packets" that are sent through its modem to the Internet and its host computers and servers worldwide.

The Coalition seeks a Commission order affirming that such calls to ISPs should be treated as local calls, under Commission jurisdiction, and subject to the bill-and-keep or reciprocal compensation provisions of applicable interconnection agreements. The Coalition seeks generic resolution of this issue within R.95-04-043, the Local Competition Docket in light of the position advanced by Pacific Bell (Pacific) claiming that calls to an ISP constitute interstate calls. Pacific believes such calls are not subject to this Commission's jurisdiction.

² For purposes of the Motion, the Coalition consists of the following parties: ICG Telecom Group, Inc., Teleport Communications Group, Inc., MCI Telecommunications Corporation, Sprint Communications Co., L.P., Time Warner AxS of California, L.P., Teligent, Inc., California Cable Television Association.

and do not qualify for the reciprocal compensation arrangements which are applicable only to local calls. The Coalition claims that, as a result of Pacific's position, CLCs are being unfairly deprived of compensation for terminating ISP traffic. Two complaint cases currently pending before the Commission raise this same issue in the context of specific interconnection agreements in dispute. The Coalition expresses concern that the two complaint cases are likely only the first of many more disputes to come if the Commission does not resolve this issue generically in this proceeding.

Responses to the Coalition's motion were filed on April 2, 1998. Responses in support of the motion were filed by various parties representing CLCs. Responses in opposition to the motion were filed by the two large incumbent local exchange carriers (ILECs), Pacific and GTE California (GTEC), and by a group of small ILECs.³ On April 16, 1998, the Coalition filed a reply to the responses of Pacific and GTEC. On May 8, 1998, Pacific and GTEC each filed a further response to the reply of the Coalition. We have taken parties' comments into account in resolving this dispute.

Position of Parties

The Coalition argues that ISP traffic meets the definition of a local call, and is subject to this Commission's jurisdiction as intrastate traffic, subject to reciprocal compensation requirements. The Coalition measures call "termination" at the point where the call is delivered to the telephone exchange service bearing the called number. The Coalition claims that where an ISP uses a

³ The small ILECs filing comments were Evans Telephone Company, Happy Valley Telephone Company, Hornitos Telephone Company, Kernan Telephone Co., Pinnacles Telephone Company, The Siskiyou Telephone Company, The Volcano Telephone Company, and Winterhaven Telephone Company.

phone line located within the local calling area of its customers, the calls to the ISP terminate when the ISP's modem answers the customers' incoming calls over local phone lines.

The Coalition thus views ISP service as constituting two separate segments, the first of which is a basic local telecommunication service, with the end user's call terminating at the ISP modem. The Coalition views the second segment as a separate data transmission which does not involve telecommunications service, but which is an enhanced information service utilizing worldwide computer networks. If the call did not terminate at the ISP modem, reasons the Coalition, then the ISP would have to be a telecommunications carrier, providing long distance service. Yet, the ISP is treated as a customer by the underlying telecommunications carriers providing the ISP service. In further support of its view that ISP traffic is intrastate in nature, the Coalition cites the FCC's *Access Charge Order* which prescribes that Information Service Providers may purchase services from ILECs under the same intrastate tariffs available to end users.

Other parties representing CLCs support the Coalition's motion, arguing that they have developed business plans based in part on the current industry practice of reciprocal compensation for local calls to ISPs. The CLCs state that the dispute over this issue creates an unacceptable level of uncertainty, warranting expedited Commission action affirming that current industry practice is correct.

The ILECs oppose the Coalition's motion, arguing that ISP traffic is not local, but is interstate in nature, and thus, not subject to this Commission's jurisdiction. As such, the ILECs argue that the Commission has no authority to require reciprocal compensation for termination of ISP traffic, which they claim is subject exclusively to FCC jurisdiction.

Pacific acknowledges that the FCC has permitted ISPs to purchase ILEC services under intrastate tariffs and has exempted ISPs from access charges, but characterizes such actions merely as indicators that the FCC has jurisdiction over these services, but has chosen for policy reasons to forbear from treating the calls as interstate with respect to access charges. The ILECs claim that the very fact that the FCC has exempted Information Service Providers from federal access charges demonstrates that it has jurisdiction over such calls, otherwise the FCC would have had no authority in the first place to grant an exemption for such calls.

The ILECs deny that calls to ISPs "terminate" at the ISP's modem, but argue that such calls remain in transit through the modem for further relay across state and national boundaries via the Internet. As such, the ILECs define ISP traffic as interstate based on the fact that the ISP sends and receives data transmitted to its local customers which may involve access to computer networks located outside of California or even outside of national boundaries. GTEC argues that a communication must be analyzed, for jurisdictional purposes, from its inception to its completion. GTEC seeks to draw an analogy between the intermediate switching of interstate calls of long distance carriers and the transmission performed by the ISP modem, connecting to worldwide web sites.

GTEC argues that ISP calls involve both intrastate and interstate elements, and as such, are inseverable for jurisdictional purposes. GTEC cites the *Memory Call* case, arguing that in it, the FCC applied an end-to-end analysis to BellSouth's voicemail service to conclude that it was jurisdictionally interstate, even though it utilized an intrastate call forwarding service to allow out-of-state callers to retrieve messages. GTEC argues that a similar analysis should apply to ISP

traffic, thereby rendering it jurisdictionally interstate. (Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corp, 7 FCC Rcd 1619 (1992).)

The small ILECs raise concern over the impact on their operations if the Commission ruled that ISP traffic be assigned to the intrastate jurisdiction. The rates and revenues of the small ILECs' depend in large measure on calculations based on intra-and-interstate calling traffic ratios. The small ILECs claim that the potential revenue shifts caused by the changes in jurisdictional assignments of the sort addressed in the Motion are so significant that Congress requires such matters to be referred to the Federal-State Joint Board. The small ILECs question the jurisdiction of the Commission to unilaterally decide the jurisdictional assignment of any traffic.

The Coalition also presents a summary of rulings which have been issued by other state commissions concerning whether reciprocal compensation should apply to local calls terminating with ISP end users. The Coalition claims that every state commission that has issued a final decision on this issue has ruled that reciprocal compensation should apply to such calls. While acknowledging that such actions are not binding on this Commission, the Coalition views such decisions as useful information, illustrating how other jurisdictions faced with this same issue have resolved it. In addition, the National Association of Regulatory Utility Commissioners (NARUC) passed a resolution at its November 1997 meeting concluding ISP traffic should remain subject to state jurisdiction.

GTEC discounts the significance of the orders from other jurisdictions cited by the Coalition, arguing that most of the cited orders merely involved interconnection complaints under specific contracts or arbitration proceedings which barely touched upon the ISP traffic issue. To the extent that the cited orders do rule that reciprocal compensation applies to ISP traffic, GTEC claims that the reasoning underlying the orders is faulty.

Discussion

The first issue to be resolved is whether calls to an ISP constitute interstate or intrastate local traffic. The question of whether ISP traffic is defined as local or as interstate has a bearing on whether such calls come within the jurisdiction of this Commission.

There is no question that the Internet services offered by an ISP involves the transmission of information beyond the boundaries of a local calling area, and which may, in fact, span the globe. The Internet itself is an interstate network of computer systems. The question, however, is whether this network of computer systems comprising the Internet can properly be characterized as a telecommunications network for purposes of measuring the termination point of a telephone call to access the Internet through an ISP. Parties dispute whether such Internet communications can properly be disaggregated into separate components, one involving the telecommunications network, and one that does not. We must consider whether the transmission of data which occurs beyond the ISP's modem constitutes an indivisible part of a total telecommunications service. This question, in turn, depends on how we define a telecommunications service and how such service is terminated.

GTEC argues that the Coalition's attempt to sever the ISP communication into separate intrastate and interstate segments is contrary to legal precedent, but that a communication must be analyzed, for jurisdictional purposes, "from its inception to its completion." (See *Teleconnect Co. v. Bell Te. Co. of Penn. et al.*, 10 FCC Rcd 1626, 1629-30 (1995), *aff'd Southwestern Bell Tel. Co. v. FCC*, No. 95-119 (D.C. Dir. June 27, 1997). GTEC cites a case in which the FCC found that a telephone service was interstate and thus subject to FCC jurisdiction even though the originating caller reached a local telephone number from out of state using foreign exchange and common control switching arrangement services. The

service permitted an end user in New York to call an out-of-state customer by dialing a local number and paying local rates. GTEC claims this case is analogous to the dispute over ISP traffic, arguing that both instances involve the use of intrastate local services, in part, to complete an interstate call.

GTEC also cites the *Memory Call* case where the FCC concluded that voice mail service is subject to interstate jurisdiction even though out-of-state callers could retrieve messages using an intrastate call forwarding service. GTEC cites the FCC findings that:

"The key to jurisdiction is the nature of the communication itself rather than the physical location of the technology. Jurisdiction over interstate communications does not end at the local switchboard, it continues to the transmission's ultimate destination... This Commission has jurisdiction over, and regulates charges for, the local network when it is used in conjunction with the origination and termination of interstate calls." (Petition for Emergency Relief and Declaratory Ruling Filed by BellSouth Corp., 7 FCC Rcd 1620-21 (1992).)

We disagree with GTEC's claim that the FCC's assertion of jurisdiction over voicemail service as cited in the *Memory Call* case has applicability to the ISP issue before us here. Even in instances where interstate services are jurisdictionally "mixed" with intrastate services and facilities otherwise regulated by the states, the FCC ruled that "state regulation of the intrastate service that affects interstate service will not be preempted unless it thwarts or impedes a valid federal policy." (*Id.*, at 1620 (para. 6).) Thus, even if ISP traffic did involve the jurisdictional mixing of interstate and intrastate services, state regulation of the intrastate portion of the service would not be preempted since no federal policy is being thwarted or impeded by requiring that such ISP traffic be considered local. The FCC has not issued any regulation on this matter.

R.95-04-043, L.95-04-044 Duque/tjs

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Moreover, contrary to its treatment of voice mail and telephone services, the FCC has not categorized Internet use via local phone connections as a single end-to end telecommunications service. The FCC has instead defined Internet connections as being distinctly different from interstate long-distance calls. For example, in its decision not to apply interstate access charges to ISPs, the FCC noted that, "given the evolution in ISP technologies and markets since access charges were first established in the early 1980s, it is not clear that ISPs use the public switched network in a manner analogous to IXCs [long-distance interexchange carriers]." First Report and Order In Re Access Charge Reform. (12 FCC Rcd 15982 at ¶ 345 (Released May 16, 1997).)

Likewise, in the FCC's Report and Order In Re Federal-State Joint Board on Universal Service, 12 F.C.C.R. 8776 (Released May 8, 1997) ("Report and Order"), the FCC concluded that "Internet access consists of more than one component." (*Id.* at ¶ 83.) The FCC reasoned that "Internet access includes a network transmission component, which is the connection over a [local exchange] network from a subscriber to an Internet Service Provider, in addition to the underlying information service." (*Id.*)

The FCC has found that "Internet access services are appropriately classified as information, rather than telecommunications, services." Report to Congress in re Federal-State Joint Bd. On Universal Service, FCC 98-67 at ¶ 73 (Released April 10, 1998). The FCC has affirmed that the categories of "telecommunications service" and "information service" are mutually exclusive. The FCC further concluded that: "Internet access providers do not offer a pure transmission path; they combine computer processing, information provision, and other computer-mediated offerings with data transport." (*Id.*) In contrast to a telecommunications service, the FCC found that: "[t]he Internet is a distributed packet-switched network . . . [where the] information is split up into small

chunks or 'packets' that are individually routed through the most efficient path to their destination." (*Id.* at ¶ 64.12.)

The FCC further explained how the service offered by an ISP differs from a telecommunications service:

"Internet access providers typically provide their subscribers with the ability to run a variety of applicationsWhen subscribers store files on Internet service provider computers to establish 'home pages' on the World Wide Web, they are, without question, utilizing the provider's capability for ... storing ... or making available information" to others. The service cannot accurately be characterized from this perspective as 'transmission, between or among points specified by the user'; the proprietor of a Web page does not specify the points to which its files will be transmitted, because it does not know who will seek to download its files. Nor is it 'without change in the form or content,' since the appearance of the files on a recipient's screen depends in part on the software that the recipient chooses to employ. When subscribers utilize their Internet service provider's facilities to retrieve files from the World Wide Web, they are similarly interacting with stored data, typically maintained on the facilities of either their own Internet service provider (via a Web page 'cache') or on those of another. Subscribers can retrieve files from the World Wide Web, and browse their contents, because their service provider offers the 'capability for ... acquiring, ... retrieving [and] utilizing ... information.'" (*Id.* at ¶ 76 (citations omitted); Report and Order, 12 F.C.C.R. 8776 at ¶ 83.)

The FCC's description of Internet service makes it clear that the transmission beyond the ISP modem is an information service, not a telecommunications service. The ISP does not operate switches as does a telecommunications carrier, and does not switch calls to other end users. Rather, the ISP answers the call, signifying that the telecommunications service is terminated at the ISP modem. Once the ISP connection with the local caller is established, the ISP uses its computer network capabilities to send and receive data transmissions over the Internet. These information transmissions are

performed utilizing technologies which are independent of the public switched telecommunications network. Moreover, the ISP is not certificated as a telecommunications carrier, and its own manipulations of data transmissions through the Internet computer network cannot properly be defined as a telecommunications service for purposes of measuring where ISP traffic is terminated. Likewise, the transmission of data through the Internet cannot reasonably be construed as an interstate telecommunications service simply because the Internet can route information from worldwide sources.

GTEC argues that the FCC's granting of an exemption from federal access charges to Information Service Providers constitutes a valid inference that the FCC exclusively regulates traffic. We disagree. The FCC's Access Charge Order was limited to interstate ISP traffic. The FCC did not assert exclusive jurisdiction over intrastate ISP issues. The FCC has historically exercised its jurisdiction over telephone carriers providing interstate enhanced services pursuant to its ancillary jurisdiction under Title I, 47 USC, Sec. 151-155. In 1990, however, the Ninth Circuit Court considered the jurisdictional issue of whether the FCC could preempt the state from the regulation of the intrastate enhanced services offered by carriers. The Ninth Circuit ruled that the state's jurisdiction over carrier-provided intrastate service does not intrude upon the FCC's jurisdiction over interstate enhanced services. The Ninth Circuit explained:

"[T]he broad language of Sec. 2(b)(1) [of the Communications Act] makes clear that the sphere of state authority which statute 'fences off from FCC reach or regulation, Louisiana PSC, 476 US at 370, includes, at a minimum, services that are delivered by a telephone carrier 'in connection with' its intrastate common carrier telephone services. When telecommunications services are delivered on an intrastate basis by telephone carriers over telephone lines, they at the very least qualify as services 'in connection with intrastate communication service by wire ... of any carrier.' (47 USC Sec.

152(b)(1).) That these enhanced services are not themselves provided on a common carrier basis is beside the point. As long as enhanced services are provided by communications carriers over the intrastate telephone network, the broad 'in connection with' language of Sec. 2(b)(1) places them squarely within the regulatory domain of the states." (Emphasis added.)

Based on the analysis above, we find that ISP service consists of two separate components, one of which is a telecommunications service over which we can have jurisdiction. Under the 1996 Telecommunications Act, Congress separately defined "telecommunications" as the "transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." (47 USC 153(43).) On the other hand, Congress defined "information services" as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the management, control or operation of a telecommunications system or the management of a telecommunications service." (47 USC 153(20).) As an information service provider, the ISP is an end user with respect to the termination point of a telecommunications service.

Consistent with the FCC's characterization of Internet service, we conclude that the relevant determinant as to whether ISP traffic is intrastate is the distance from the end user originating the call to the ISP modem. If this distance is within a single local calling area, then we conclude that such call is a local call, and subject to this Commission's jurisdiction. In contrast to ISP calls, long distance voice calls terminate at a remote location outside of the local calling area.

Our finding that calls to the modem of an ISP constitute local telephone traffic does not contradict case law finding that Internet transactions may involve

interstate commerce or that the "nature" of a communication, not the physical location of telecommunications facilities, is the proper determinant of FCC jurisdiction. The exercise of jurisdiction by the FCC and Congress includes authority over the Internet's information service component which involves transmissions across computer networks beyond the ISP modem and the transactions which occur over those networks. The jurisdiction of this Commission covers the intrastate telephone line connection between the ILEC's end user and the ISP modem.

The treatment of an ILEC customer call to an ISP modem as a local call is consistent with our Consumer Protection rules adopted in this proceeding where we defined a "completed call or telephonic communication to be a "call or other telephonic communication, originated by a person or mechanical device from a number to another number which is answered by a person or mechanical/electrical device." (D.95-07-054, App.B, Sec. 2.5.) Based on this definition, the ISP call is properly viewed as terminating at the ISP modem, at which point the originating call is answered, and the ISP connection established. Accordingly, the determination of whether the call is local is based upon whether the rate centers associated with the telephone numbers of the end user and the ISP provider are both within the same local calling area.

Thus, we conclude that we have jurisdiction over the intrastate telecommunications service component of ISP traffic, and thus have authority to deem these calls local.

Payment of Reciprocal Compensation Fees

Parties' Positions

The Coalition claims that CLCs are being unfairly deprived of reciprocal compensation fees for terminating the ISP traffic originated by ILEC

customers. The Coalition claims Pacific has violated PU Code Sec. 453 by refusing to treat calls to ISPs as local calls eligible for reciprocal compensation. Sec. 453 prohibits public utilities from granting "any preference or advantage to any corporation or person" or subjecting "any corporation or person to any prejudice or disadvantage" as to "rates, charges, service, facilities or in any other respect ... as between classes of service." The Coalition claims that while Pacific collects local measured usage or Zone Usage Measurement (ZUM) Zone 3 charges on the party originating calls to Pacific's own Internet access service, Pacific discriminates against CLCs by refusing to share this revenue for calls from ILEC customers to ISPs served by CLCs. Pacific also receives revenues on flat rate service (\$11.25 per month) over the rate for measured rate service (\$6.00 per month). The Coalition cites this \$5.25 per month differential as compensation for Pacific's costs for usage associated with flat rate service for which there is no extra charge. Likewise, GTEC receives usage revenue on ISP calls, ZUM Zone 3 revenues, and a \$7.25 increment over measured rate service in its flat rate charge.

Because Pacific does not share any compensation received from such callers with the CLC that incurs the cost to terminate the call to the ISP, the Coalition claims such differential treatment produces an unfair competitive edge for Pacific and violates Sec. 453(a) and (c). The Coalition argues that CLCs are entitled to receive compensation for terminating inbound calls in the same manner as Pacific and its own Internet operations do. As the volume of ISP traffic continues to grow at explosive rates, the Coalition argues, the CLCs' burden of terminating ISP calls correspondingly grows greater.

Pacific denies the charge that it has violated Sec. 453, arguing that most of its customers pay no additional charge for each individual local call, but are subject generally to local flat rate service. Likewise, Pacific's customers do not pay ZUM Zone 3 charges for ISP calls since CLCs specifically assign

telephone numbers to ISPs from NXX codes that permit customers to avoid such charges. Pacific claims that its prices of \$11.25 for flat rate service and \$6 for measured rate service do not even cover its costs of providing local service to its own customers, much less the costs associated with calls from its customers to ISPs serviced by a CLC. Pacific argues that these prices were not designed to cover the costs associated with ISP usage where customers maintain their connection to the ISP for extended periods of time. Thus, Pacific denies that it collects any surplus revenues for ISP calls which can be shared with CLCs.

Pacific claims that it would be confiscatory to ILECs to require them to pay CLCs for the termination of ISP traffic. Since virtually all of the ISP traffic is one-way, Pacific argues, the compensating per-minute termination charges would likewise flow asymmetrically to the CLCs that have the customer relationship with the ISPs. The ILEC would thus pay both the costs of originating and terminating ISP traffic.

The ILECs argue that, even if the Commission concludes that it has jurisdiction over such calls, reciprocal compensation for ISP traffic should not be authorized as a matter of policy. Because ISPs receive calls, but almost never originate calls, the CLC would receive payment for terminating ISP traffic, but would seldom, if ever, pay for termination of outgoing calls originating from the ISP. At the same time, the ILEC would have to bear the call origination costs plus the per-minute charges paid to the CLC for terminating the call. The ILECs claim such an arrangement would place an unfair and extraordinary burden on the carrier which originates the call. On the other hand, the CLCs argue that it is they who are disadvantaged by the obligation to terminate calls originated by the ILECs' customers to ISPs.

The ILECs warn that, if ISP traffic is deemed local, and the Commission requires that reciprocal compensation fees apply to ISP traffic, CLCs

stand to gain millions of dollars in one-way reciprocal compensation payments under interconnection agreements with the ILECs, thereby subsidizing CLCs' businesses and undermining local competition. GTEC argues that no local carrier would voluntarily serve a subscriber if it stands to pay more in reciprocal compensation fees than it receives for providing local telephone service to the subscriber. Pacific argues that the payment of termination fees to the CLCs for ISP traffic will create an incentive for CLCs to "game" the system in a competitively abusive manner. For example, Pacific claims that at least one CLC appears to be using fees received from Pacific for terminating ISP traffic to fund payments to ISPs for traffic delivered to them. Pacific cites the marketing practice of a Pac-West offer that ISPs can "get paid for offering free Internet Access." Pacific claims that instead of charging ISPs to connect to the CLC network, the CLC can remit some of their reciprocal compensation fees to pay the ISPs for connecting the CLCs in the first place. Pacific believes the payment of reciprocal compensation fees for ISP traffic creates the wrong incentives encouraging such marketing practices.

Discussion

All matters affecting the internet have a special importance to California and Californians. To a large extent, the internet as we know it is the creation of scientists, technicians, government, telecommunications companies and workers living in the Silicon Valley, a scant 20 miles south of this Commission's San Francisco headquarters. The Southern part of our state - the television and motion picture industries - provides much of the high-bandwidth content that travels over the information infrastructure of this country. With this in mind, it is not surprising that Section 709 of the Public Utilities Code singles out these issues concerning telecommunications infrastructure for special discussion:

"709. The Legislature hereby finds and declares that the policies for telecommunications in California are as follows:

(a) To continue our universal service commitment by assuring that continued affordability and widespread availability of high-quality telecommunications service to all Californians.

(b) To encourage the development and deployment of new technologies and the equitable provision of services in a way which efficiently meets consumer need and encourages the ubiquitous availability of a wide choice of state-of-the-art services.

(c) To promote economic growth, job creation, and the substantial social benefits that will result from the rapid implementation of advanced information and communications technologies by adequate long-term investment in the necessary infrastructure.

(d) To promote lower prices, broader consumer choice, and avoidance of anti-competitive conduct.

(e) To remove the barriers to open and competitive markets and promote fair product and price competition in a way that encourages greater efficiency, lower prices, and more consumer choice." (P.U. Code §709)

This codified policy statement gives this Commission has a special obligation to ascertain in advance how our regulatory decisions affect the state's information infrastructure.

Unfortunately, the record in this proceeding concerning the policy implications of pricing internet traffic is inadequate. The issue of whether to subject past, current, and future internet traffic to the reciprocal compensation terms included in many contracts was one not squarely addressed by this Commission previously. We know of no arbitration ruling or Commission decision that discusses the special pricing that the FCC has ordered for this traffic as a consideration affecting our own pricing of this traffic.

This record stands in sharp contrast to that developed for the termination of paging traffic. Concerning this matter, the Commission has a major precedent that upholds the reciprocal compensation provisions of an interconnection

agreement ordered by this Commission. In this precedent involving a one-way traffic to a paging carrier, the Court stated:

"The Court agrees with Cook and the CPUC that nothing in the Act precludes one-way carriers such as Cook from entering into reciprocal compensation agreements with LECs. The Act requires only that the agreements be 'reciprocal' in that each carrier agrees to pay the other for the benefits it receives from the other carrier when the other carrier terminates a call that originates with the first carrier. The compensation agreement between Cook and Pacific Bell does so. Nothing in the statute's language indicates that such compensation agreements are not required if a disproportionate number of calls will originate with the facilities of one carrier or if no calls will originate with those of the other carrier." (Pacific Bell v. Telecom, Inc., U.S. D. C.; Judgment No. C97-03990 Civ.; September 3, 1998)

In setting our policy regarding paging companies, the Commission carefully considered the imbalance of traffic flow and the unique costs associated with paging traffic. In sharp contrast to this considered step, we know of no record in the arbitrated interconnection agreements between ILECs and CLCs that either directly addressed the imbalance in ISP traffic flow or any special pricing/costing characteristics associated with this type of communication.

To resolve the issues put before us, we will permit parties to this proceeding to file comments limited to twenty-five pages that address the following questions:

1. Do calls to ISPs have special characteristics that should affecting pricing policies?
2. What is the size of this issue for California? What revenue flows between carriers result from internet traffic? How can we expect these flows to change over time?
3. Have other regulatory jurisdictions addressed the pricing of internet access services directly? What policies have they adopted?

4. What affects will different pricing policies have for the development of the state's information infrastructure? How will they affect investments in ADSL, ISDN, and other specialized data services?
5. What affects will pricing policies have on the entry of carriers hoping to offer telecommunications services in support of internet services?
6. What pricing policies consistent with current statutes would best serve the growing needs of California's telecommunications and information infrastructure? What pricing policies are best for California? Why?

Opening comments, limited to 25 pages, are due within 45 days of the adoption of this order. Reply comments, limited to 15 pages, are due 15 days after the filing of opening comments.

We also note that we take no action here regarding the merits of the complaints filed against Pacific Bell in separate proceedings before this Commission.

Impacts on Interstate/Intrastate Calling Ratios

We are not persuaded by the arguments of the small ILECs that we should refrain from deciding the jurisdictional status of ISP traffic because it could adversely affect the revenues of the small ILECs which is based on intrastate-interstate calling traffic ratios. Our ruling that ISP traffic is intrastate is consistent with the manner in which such traffic has been treated in interconnection agreements. In any event, to the extent that a small ILEC believes it will experience a material revenue impact as a result of a change in jurisdictional calling traffic ratios, it may seek recourse through its general rate case process. Therefore, the issues resolved in this order concerning our jurisdiction over ISP traffic should not have any adverse impact on the traditional manner in which the small ILECs have determined traffic ratios for rate and revenue purposes.

Findings of Fact

1. Disputes have arisen in interconnection agreements over which carrier should pay for the cost of terminating calls originated by customers of one local carrier to access Internet Service Providers (ISPs) which, in turn, are telephone customers of another local carrier.
2. The question of whether ISP traffic is subject to call termination charges depends, in part, on whether such traffic is defined as local or as interstate, and consequently, on whether such calls come within the jurisdiction of this Commission.
3. Provision for reciprocal compensation for call termination in interconnection agreements only applies to local traffic originating and terminating within a local calling area.
4. ISP service is composed of two discrete elements, one being a telecommunications service by which the end user connects to the ISP modem through a local call, the second being an information service by which the ISP converts the customer's analog messages into data packets which are individually routed through its modem to host computer networks located throughout the world.
5. Under the 1996 Telecommunications Act (Act), "telecommunications" is defined as the "transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received." (47 USC 153(43).)
6. The Act separately defines "information" services" as "the offering of a capability for generating, acquiring, storing, transforming, processing, retrieving, utilizing, or making available information via telecommunications, and includes electronic publishing, but does not include any use of any such capability for the

management, control or operation of a telecommunications system or the management of a telecommunications service." (47 USC 153(20).)

7. Even where interstate services are jurisdictionally mixed with intrastate services and facilities otherwise regulated by the states, the FCC has ruled that state regulation of the intrastate service will not be preempted unless it thwarts or impedes a valid federal policy.

8. The U.S. Court of Appeals for the Ninth Circuit has ruled that state jurisdiction over carrier-provided intrastate enhanced services such as ISP calls does not intrude upon FCC's jurisdiction over interstate enhanced services offered by carriers.

9. The relevant determinant of whether ISP traffic is intrastate is the whether between the rate centers associated with the telephone number of an end user originating the call and the telephone number at the ISP modem where the call is terminated are both intrastate.

10. If the transmission between the rate centers associated with the telephone numbers end user originating the call to the ISP modem lies within a single local calling area, then such call is a local call.

11. The issues resolved in this order concerning our jurisdiction over intrastate calls to ISPs should not have any adverse impact on the traditional manner in which the small ILECs have determined traffic ratios for rate and revenue purposes.

12. The fact that ISP traffic flows predominantly in one direction does not negate the costs involved in terminating traffic.

Conclusions of Law

1. This Commission has jurisdiction over transmissions originating from an end user and terminating at an ISP modem where both the end user and modem are intrastate.

2. This Commission has jurisdiction to issue an order ruling on whether a transmission terminating at an ISP is to be subject to the reciprocal compensation provisions of interconnection agreements.

3. California has adopted statutory provisions to set state telecommunications policies to guide the Commission's regulation of telecommunications infrastructure.

4. It is prudent to determine how alternative policies for pricing traffic to an ISP modem will affect access to and investment in California's information infrastructure.

O R D E R

IT IS ORDERED that:

Parties wishing to participate in the Commission's proceeding to determine policies for pricing telecommunications directed to an ISP modem should file and serve comments addressing the following questions:

1. Do calls to ISPs have special characteristics that should affecting pricing policies?
2. What is the size of this issue for California? What revenue flows between carriers result from internet traffic? How can we expect these flows to change over time?
3. Have other regulatory jurisdictions addressed the pricing of internet access services directly? What policies have they adopted?
4. What affects will different pricing policies have for the development of the state's information infrastructure? How will they affect investments in ADSL, ISDN, and other specialized data services?
5. What affects will pricing policies have on the entry of carriers hoping to offer telecommunications services in support of internet services?
6. What pricing policies consistent with current statutes would best serve the growing needs of California's telecommunications and information infrastructure? What pricing policies are best for California? Why?

Opening comments are limited to 25 pages and due within 45 days of adoption of this order. Reply comments are limited to 15 pages and due within 15 days of the filing date of opening comments.

This order is effective today.

Dated _____, at San Francisco, California.

**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking on the)	
Commission's Own Motion into)	
Competition for Local Exchange Service)	R. 95-04-043
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Order Instituting Investigation on the)	
Commission's Own Motion into)	
Competition for Local Exchange Service)	I. 95-04-044
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NOTICE OF EX PARTE COMMUNICATION

Pursuant to Rule 1.4 (a) of the Commission's Rule of Practice and Procedure, Pacific Bell (U-1001-C) provides the following notice of ex parte communications.

On Thursday, September 24, 1998, Jim Callaway, President Pacific Telesia, Bill Blase, Vice President-Regulatory, Pacific Bell, David Discher, General Attorney, Pacific Telesis, and Dan Jacobsen, Executive Director Regulatory, Pacific Bell, met with Commissioner Duque and Advisor Tim Sullivan. The meeting was requested by Pacific Bell and it occurred at approximately 10:30 a.m. at the Commission offices at 505 Van Ness Ave., San Francisco, Ca. Representatives from Pacific Bell made the following points: Internet calls are not local, Reciprocal compensation would have a significant negative financial impact on Pacific Bell, the policy implications on this issue are significant, other states have not addressed the policy implications related to reciprocal compensation and some CLECs and DXCs have agreed with Pacific's position.

The attached handout was used during the meeting.

To obtain a copy of this notice, please contact:

Lila Tam
Pacific Bell
140 New Montgomery Street, Room 2519
San Francisco, CA 94105
Tel: (415) 542-3820
Fax: (415) 543-3766

Dated at San Francisco, California, this 28th day of September, 1998.

Respectfully submitted,



Daniel O. Jacobsen
Executive Director - Pacific Bell Regulatory
(415) 545-1580